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SUBJECT: DIAMONDS ARE BOTSWANA'S BEST FRIEND

REF: JUNE 4 2008 EMAIL FROM E. PELLETREAU

¶1. Summary. With the opening of the Diamond Trading Center (DTC), Botswana has successfully moved up the value chain in the diamond industry. No longer just a raw producer of diamonds, Botswana is now host to all steps in the diamond industry - from mining and producing to sorting, cutting, and polishing to aggregating and selling to the world market. The country will reap the benefits from the DTC in terms of revenue and job creation well into the future or as long as Botswana's diamond mines continue to produce high value gems. End Summary.

Economic Effect

¶2. Despite efforts to diversify, diamonds still drive Botswana's economy and have underpinned its economic growth from one of the poorest countries at the time of its independence in 1966 to its current middle-income status. As former President Festus Mogae said at the opening of the recently completed Diamond Trading Center in Gaborone, "Botswana is what it is because of diamonds."

¶3. For the 12-month period ending June 30, 2007, diamonds accounted for 67 percent of total exports (down from a high of 84 percent in 2003/04) and 28 percent of GDP (based on current prices in pula). Diamond mining, however, is capital intensive and only accounts for approximately five percent of employment.

Debswana

¶4. Debswana, a 50-50 joint venture between De Beers and the GOB, operates the four active diamond mines in Botswana, including the Jwaneng mine, the world's richest diamond mine by value. According to the Debswana 2007 annual report, the four open pit mines account for 27 percent of the world's diamond production by value, making Debswana (and Botswana) the world's leading producer of diamonds by value. In 2007, Debswana produced 33.8 million carats, down slightly from 34.3 million carats in 2006 but 2007 revenue was 18 billion pula (approximately US\$ three billion), a 3.5 percent increase from 2006.

¶5. Debswana is faced with many challenges to contain costs in the future. Inflation has increased its operating costs, regional and local power shortages are affecting its productivity, and the shortage of construction equipment, especially tires, due to worldwide demand is affecting its operations. Production and profits will also decline as production moves underground and costs rise, which is expected to happen in 2020.

Other Diamond Mining Companies

¶6. The success of Debswana has attracted other hopeful entrants to the diamond mining sector in Botswana. Unlike

the Debswana mines, however, the ones expected to open will be much smaller than the existing mines, have a relatively short life, and are unlikely to be nearly as profitable as the Debswana mines.

¶17. Boteti Exploration Company, a joint venture between De Beers (66 percent owner), African Diamonds Plc (29 percent owner), and Debwat (a joint venture between De Beers and Wati Ventures; 5 percent owner), began mine construction in April 2008 of a mine in central Botswana near three of the Debswana mines. The diamond pipe was discovered in 1969 but was considered uneconomic until new technologies revised the estimated size of the pipe and further sampling indicated higher grades than originally thought. The mine, which the company hopes to have ready by the last quarter 2009, has an expected life of 10 years and an estimated reserve of 11.1 million carats.

¶18. DiamonEx, an Australian-based diamond exploration company, through its Botswana subsidiary is the sole owner of the Lerala Diamond Mine, located in eastern Botswana with an estimated reserve of 3.7 million carats. The company expects to begin production in July 2008 and to produce 330,000 carats per year. DiamonEx also owns 15,000 square kilometers of mineral rights in Botswana, which it is actively exploring for diamonds.

¶19. Gem Diamonds, a London stock exchange listed company, through its wholly-owned Botswana subsidiary Gope Exploration Company, has plans to develop the Gope mine located within 20 miles of the eastern border of the Central Kalahari Game Reserve (CKGR) by 2010. However, the mine's location inside the CKGR (which is the home of the San indigenous people) make this project highly sensitive and it will require additional consultations with the GOB and civil society. If successful, the company believes the mine will produce one million carats annually with an estimated life of 15 years.

Diamond Trading Company Botswana

¶10. In exchange for extending the Jwaneng mining license another 25 years, De Beers agreed to enter into a joint venture with the GOB to operate the Diamond Trading Center Botswana (DTCB), the rough diamond distribution arm of De Beers, in Gaborone. The DTCB was the fulfillment of former President Mogae's goal to move up the value chain in diamond processing by developing sustainable post-extraction diamond industries in Botswana.

¶11. The US\$75 million state-of-the-art sorting and valuing facility opened in March 2008 with 500 employees, although not all are in the cutting and sorting areas. Eventually DTCB expects to have 3,000 employees. The facility with its three sorting floors and 39 modern sorting machines is the biggest diamond sorting facility in the world.

¶12. DTCB has the capacity to sort and cut 45 million carats per year. Any shortfall from Debswana, which currently produces around 34 million carats per year, will be made up by production from new mines in Botswana or through aggregating diamonds from other countries such as Canada and South Africa.

¶13. DTCB expects to supply close to US\$550 million worth of diamonds to 16 local sightholders by 2009. DTCB has already completed two sales in April and June 2008 and it expects to sell US\$375 million worth of diamonds in 2008. Once fully operational, DTCB plans to conduct 10 sales per year.

¶14. DTCB will concentrate on the upper and middle ends of the supply chain in order to stay competitive in the global diamond cutting and sorting business. Botswana cannot compete with other cutting centers because its labor force is too costly -- approximately five times higher than that in India or China -- and inexperienced compared to others. DTCB, therefore, will focus on larger, more expensive stones for which the labor component is a smaller proportion than

for lower value gems, which will remain a specialty of India.

¶15. In addition to the direct jobs created, the DTCB should create additional jobs in downstream activities like banking, security, insurance, IT, and others. Stanbic Bank Botswana, a leading South African bank operating in Botswana, has already announced that it will use its proceeds from a US\$300 million bond offering to support the downstream diamond beneficiation industry including financing of working capital for the 16 diamond cutting and polishing companies in Botswana and international banks such as ABN AMRO have expressed an interest in opening in Botswana.

DTC International

¶16. De Beers also has announced that it will bring its aggregation business (DTC International) to Botswana by the middle of 2009. DTC International combines US\$ six billion worth of diamonds sourced from various producer countries including Russia. Aggregation is currently done in London, but producer countries will now sort their diamonds and then send them to Botswana to be mixed and sold. With the opening of DTC International, Botswana will now play host to all steps in the diamond industry - from mining and producing to sorting, cutting, and polishing to aggregating and selling to the world market.

Sightholders

¶17. As part of the requirement to buy from DTCB, sixteen sightholders have set up polishing, sales, and marketing businesses in Botswana. Four have been in business in Botswana for many years, but the remaining 12 are still ramping up operations due to the opening of DTCB. The sightholders are well-known diamond businesses with headquarters in Geneva, Israel, Belgium, India, and elsewhere. U.S.-based sightholders who have established local operations include Ascot Diamonds, Lazare Kaplan, and Leo Schacter.

¶18. With the opening of DTCB, the sixteen sightholders have been aggressively setting up operations in and around Gaborone. Steinmetz Diamonds Group, a Swiss-based multinational diamond company with activities that include rough diamond sourcing, trading and marketing, diamond manufacturing and cutting, polished sales and marketing, as well as jewellery creation and retail, invested US\$ nine million in building a factory, which will accommodate 220 employees. Pluczenik Group, a veteran De Beers sightholder from Belgium, invested US\$ three million in a plant that it expects to employ 400 people. H and A Cutting Works from Belgium opened in January and now employs 170 workers with plans to increase to 500. Other sightholders are making similar investments.

¶19. With De Beers, the GOB, and DTCB holding all the cards, the sightholders have little choice but to express optimism that they will be able to overcome the high labor and transport costs, low productivity, and power problems associated with doing business in Botswana. Many have mentioned the cost saving of setting up and sourcing their diamonds locally as compared to sourcing their diamonds in London as had been previously done. At a news conference at its Botswana opening, the chairman and chief executive officer of the Pluczenik Group said they intended to use advanced cutting technology and sophisticated machinery to reduce costs.

¶20. However, not all are happy, as Dalumi Diamonds Group (DDG), an Israeli cutting and polishing firm, has already publicly complained about the high transport costs in Botswana and is experiencing labor problems as employees went on strike over wages. In a newspaper interview, the DDG CFO also complained about the lack of tax incentives found in other diamond cutting and polishing countries and the lack of competition among Botswana cities and provinces to attract

businesses that is normally found in other countries, which usually drives down operating costs for the company.

Comment

¶21. The GOB has played its diamond cards well to get De Beers to open the DTCB, which should provide long term benefits to the country in terms of revenue and job creation, and make tiny Botswana an even bigger player in the diamond industry. It remains to be seen if the sightholders can be profitable in the Botswana business environment but they have little choice but to try to make it work so long as Botswana's diamond mines continue to produce the diamonds they want and need. Until the mines play out, diamonds will continue to be Botswana's best friend. End comment.

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